Rising Income Inequality - And What Can be Done about It

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Amid raging debates about wealth disparities, we should keep in mind that researchers have more and better evidence about sharp increases in income inequality. Everyone who has studied the evidence agrees that income inequality has risen in almost every rich democracy since the late 1970s. What is more, although every affluent democracy uses some combination of taxes and government benefits to limit the level of inequality, some nations do far more than others – and the United States is among the countries doing the least to limit gaps in family incomes.

Income Inequality in the United States

Economists distinguish two measures of income. *Market income* includes earnings, private pensions, and income from assets like stocks and bonds. According to the Luxembourg Income Study, inequalities in market income inequality are currently about the same in the six biggest rich democracies: Britain, France, Germany, Italy, Japan, and the United States. But *disposable income* is the amount that families end up with after government benefits are added to market income, and after taxes on income and expenditures are subtracted.

This distinction is critical for understanding where the United States stands compared to the other five big rich democracies, because the U.S. national government does considerably less than the others to equalize disposable family incomes – which end up being more unequal in America than in any other rich democracy. (State and local taxes actually *increase* U.S. inequality, but we have no evidence for their effects in the other five big rich democracies.)

Income inequality in the United States has risen in recent decades for three main reasons.

- For many families, incomes are dragged down by declining job opportunities and employment among less skilled workers, which have contributed to a dramatic increase in the fraction of children living in households without a male breadwinner.
- The supply of college graduates has not kept pace with demand since the 1970s, so the income gap between the upper-middle class and people in the middle of the distribution has widened.
- Deregulation, globalization, and financial speculation have doubled the share of income going to the top one percent of U.S. income earners, who have managed to do well in booms and after busts. Indeed, once the economy began to grow again after the 2008 financial meltdown, the top one percent raked in over half the income gains.

Can America Limit and Reverse Income Inequalities?

The answer depends on whether most Americans can overcome aversion to government. Most Americans tell pollsters that income inequality is too high, but when asked if they favor government efforts to reduce inequality, most say no. That's rather like saying the crime rate is too high but the police and other public agencies should not take steps to reduce it. Private charity is fine, but only a small minority of the rich give away much of their money – and their gifts often go to privileged institutions. Very few wealthy people are even prepared to accept high inheritance taxes that would make it harder to pass billions directly to their children.

Voluntary corporate steps are not likely to work, either. Over the past several decades, successful U.S. corporations have aimed to replace workers with machines whenever possible; and when that is not possible, they aim to replace well-paid workers with badly-paid workers. This happens not because corporate executives are personally wicked, but because corporate boards have become convinced that their main goal should be to maximize "shareholder value" regardless of how the effort will affect their workers. If Americans want corporations to behave differently, the U.S. government would have to do what Germany did after World War II: legally require firms' governing boards to include representatives of their workforce as well as stockholders.

Steps U.S. Government Could Take

Forcing changes on corporate boards does not seem as likely as various other steps U.S. government could take with regulations, social benefits, and taxes.

- America needs more private-sector jobs that pay enough to support a family – especially jobs for workers who are short on academic skills but long on reliability, determination, helpfulness, and the other virtues that make both families and organizations work better. Private firms are not likely to raise wages voluntarily and government cannot directly create enough well-paid jobs. **But the U.S. government could tax corporate profits and use the revenue to supplement wages, or it could take regulatory steps liking increasing the minimum wage.** Public benefits like Food Stamps, rent subsidies, and the Earned Income Tax Credit have significantly reduced poverty over the past fifty years. But family incomes are still lagging and it might be easier in the long run to pressure firms to pay more than for Congress to approve enough tax revenue to supplement tens of millions of paychecks.

- **U.S. college graduation rates must also improve.** Preparation for college has to start early in life, by getting young children to start thinking about puzzling questions and continue to do so as they move through elementary and secondary school. But America also needs to reorganize higher education so that students move through college in four years, with peers and friends on a shared track. In addition, the financial risk of college attendance must be reduced. Today, if a student attends a typical public college on borrowed money, he or she has a fifty-fifty chance of ending up with a lot of debt but no four-year degree. Thanks to financial sector lobbying, that trap can never be escaped by personal bankruptcy. Under these circumstances, no one should be surprised that so many students from less-than-affluent families skip college or end up dropping out.

- Finally, if Americans want to reduce income gaps, **soaring windfalls from the U.S. financial sector must be taxed at Eisenhower era rates. And Wall Street must be regulated**, so that it goes back to being a service industry rather than a casino – where the super-affluent keep winning and putting the economy at risk of meltdowns for everyone else.

Policies like these – to counter various causes and types of growing U.S. income inequalities – could make a real difference in coming decades. But they won't happen unless Americans decide that government can do what they say they want: limit windfalls flowing to the super-rich and enlarge opportunities for most workers and families to get ahead.